



# Excise Tax Advisory

Excise Tax Advisories (ETAs) are interpretive statements issued by the Department of Revenue under authority of RCW 34.05.230. ETAs explain the Department's policy regarding how tax law applies to a specific issue or specific set of facts. They are advisory for taxpayers; however, the Department is bound by these advisories until superseded by Court action, Legislative action, rule adoption, or an amendment to or cancellation of the ETA.

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## **Manufacturers' Machinery and Equipment Exemption — Electrical Apparatus and Utility Systems**

The Department has issued a series of Excise Tax Advisories (ETAs) to address questions regarding the retail sales and use tax exemption provided by RCW 82.08.02565 and 82.12.02565, commonly referred to as the manufacturers' machinery and equipment exemption (M&E exemption). This advisory, ETA 2012-3S, is issued to address the application of the M&E exemption to electrical apparatus and utility systems. Please refer to ETA 2012.08.12.13601 for a current list of the issues covered by this series.

The M&E exemption defines "machinery and equipment" as "industrial fixtures, devices, and support facilities." Questions have been asked regarding the eligibility of apparatus such as transformers, switches, and circuit breakers, and of system components such as conduit and wiring.

The M&E exemption defines "machinery and equipment" as "industrial fixtures, devices, and support facilities." Electrical apparatus and utility systems are either "industrial fixtures" or "devices" and thus eligible for the M&E exemption if "used directly" in a manufacturing operation, testing operation, or research and development operation.

The M&E statute identifies eight separate criteria under which machinery and equipment is considered "used directly." Qualifying under any one of the eight tests is sufficient to establish eligibility for the M&E exemption. Electrical apparatus and utility systems are eligible for the M&E exemption if the apparatus or system:

- (1) Acts upon or interacts with an item of tangible personal property;
- (2) Produces power for, or lubricates machinery and equipment; or
- (3) Is integral to research and development.

### ***Electrical Apparatus – Research and Development Operations***

Electrical apparatus used directly in a research and development operation need only be "integral" to the research and development operation to be entitled to the M&E exemption. There is no requirement that it act upon or interact with an item of tangible personal property or produce power for machinery and equipment.

*Advisories numbered as 2 plus three digits (e.g. 2002.16.179) are advisories issued on or after July 2, 1998.*

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### ***Electrical Apparatus—Manufacturing Operations and Testing Operations***

Electrical apparatus such as motor control centers, starters, switches, regulators, and exciters “act upon or interact with” tangible personal property, often in a sequential manner. The motor control center, for example, produces an action that results in a reaction by the motor. Switches and exciters work in much the same way. Similarly, circuit breakers and comparable equipment react to an event in another item, and this cause and effect behavior falls under the “acts upon or interacts with” criteria. Thus, these items are eligible for the M&E exemption, subject to meeting the other requirements of the exemption.

Converters, transformers, and other equipment on site, that alter the characteristics of the electricity “produce power” for machinery and equipment, and qualify for the M&E exemption, subject to meeting the other requirements of the exemption. Apparatus that are part of a utility system used for qualifying and nonqualifying purposes should be examined using the allocation standard set forth below.

Transmission and distribution systems located off site do not qualify for the M&E exemption.

### ***Utility Systems used for Qualifying and Nonqualifying Purposes – Allocation***

The M&E exemption defines “machinery and equipment” to, in part, exclude

building fixtures that are not integral to the manufacturing operation, testing operation, or research and development operation that are permanently affixed to and become a physical part of the building, such as utility systems for heating, ventilation, air conditioning, communications, plumbing, or electrical. RCW 82.08.02565(2)(b)(iv).

Conversely, building fixtures are eligible if they are integral to the manufacturing operation, testing operation, or research and development operation, and meet the other requirements of the exemption, such as the “used directly” test. Thus, while the M&E exemption contemplates that these utility systems are to be separately considered as potentially eligible industrial fixtures and not a part of a “building” for purposes of exemption, not all such systems are eligible for the exemption.

Utility systems that serve a building purpose, as opposed to a manufacturing purpose, do not qualify. For example, a utility system used to perform a general building purpose, such as a HVAC system controlling the air temperature or air quality in general, is not eligible for the M&E exemption.

If a utility system is used for both qualifying and nonqualifying purposes, the system should be allocated so that only the qualifying portion of the system receives the exemption, and the building portion does not receive an exemption.

One way of allocating a utility system is by applying the ratio of the qualifying use made of the system to the total use of the system. This ratio must be established and substantiated by sufficient documentation, such as, but not limited to, engineering analyses and power bills. Thus, if the taxpayer can document that 30 percent of a system is used for the manufacturing activity (e.g., 30 percent of the

system is dedicated to manufacturing frozen raspberries vs. 70 percent dedicated to cold storage) then this 30 percent qualifies for the exemption.

The concept of allocating portions of a utility system as qualifying or nonqualifying for purposes of the M&E exemption is limited to utility system machinery and equipment considered a building fixture, when used to support both manufacturing machinery and equipment and the building systems. Allocation is not applicable to any other situation. In other areas dealing with dual use of machinery and equipment (dual use meaning property is used in both qualifying and nonqualifying activities) the majority use threshold is applicable. Rule 13601(10) sets forth the criteria used in applying the majority use test.

The statute specifically excludes from the scope of the M&E exemption building fixtures that are not integral to the manufacturing operation. This directly implies that building fixtures that are integral can qualify. However, application of the majority use test to building fixtures would conflict with the legislative intent because it would provide a total exemption for such property. The allocation between exempt use and nonexempt use of a utility system achieves the Legislature's intent in this area.